Learning How to Invest in the Stock Market

According to *Financial Management: Theory and Practice*:

- In the past 75 years pension funds, insurance companies, and mutual funds have exploded in growth. These institutions now own more than 58 percent of all stock, which means that most individuals have an indirect stake in the stock market.
- In addition, more than 48 percent of U.S. households own stock directly.

Investments in stocks can give better returns than many other investment options. Investing in the stock market, however, is a risk. To minimize your risk you will need to do your homework. Please consider your investment objectives, risks, fees and expenses carefully before investing. The following is the basic terminology and principles of the stock market.

What is Stock?
If a company wants to raise capital (money) they can take several actions including taking a loan from the bank, issuing bonds, or issuing stock. The latter option allows the company to raise capital without creating debt. People who buy the stock (shareholders) actually buy a share of the company. Any person or institution who owns over a majority of the stock is called the "controlling shareholder."

How Money is Made

- **Dividends**- A portion of a company's profits that the company may pay shareholders on a quarterly or annual basis. In lieu of dividends, some companies choose to reinvest their profits. This, in theory, will drive up stock prices.
- **Stock Increases**- You can also make a profit if the market value of your stock increases relative to the purchase price.

Market Measurers
Market indexes like Dow Jones and the S&P 500 can provide a snapshot of how the overall market is performing at any given time. The NASDAQ is actually an exchange that is often used as a measure of performance.

- **Dow Jones**- The Dow Jones Industrial Average is an index of 30, blue chip stocks (some of the largest companies in the United States).
- **S&P 500-** The Standard and Poor's 500 is an index of 500 different stocks.
- **NASDAQ Composite-** The National Association of Securities Dealers Automated Quotations is where most tech stocks are traded and is used as a measure to determine the overall performance of tech stocks.

How to Purchase Stocks
In order to purchase stocks you either have to go through a broker or buy directly from the company**.**

- **Brokers**- A broker is an individual who buys or sells stocks, bonds, or mutual funds for you. Make sure your broker is registered with the National Association of Securities Dealer (NASD) on their website at www.nasd.com. Brokerage services vary in costs and

services. The traditional, full service brokerages offer professional advice at a larger price tag. Discount, on-line brokerages give little to no personal attention for a small fee.
- **DRIPS & DIPS**- Dividend Reinvestment Plans (DRIPS) and Direct Investment Plans (DIPS) are plans that allow investors to purchase stock directly from a company. These allow investors to invest small amounts of money at regular intervals.

Picking Stocks
The core principle in the stock market is to "buy low and sell high." So the key is to find companies that are good values. Just because a stock is inexpensive does not make it a good value. Here are just a few clues to look for in a company's annual report to help you find a good value:
- **P/E ratio**- This is the price-to-earnings ratio that measures the relationship between the current price of one share of a company's stock and the company's annual earnings per share. For example, if a company's stock price is $30 and their P/E ratio is 20. The company's earning per share is $1.50. Therefore, shareholders are paying $20 for every $1.50 that the company earns.
- **Shareholder's Equity**- A company's total assets subtracted by the company's total liabilities is the amount of shareholders' investment in the company.
- **Debt-to-equity ratio**- A company's total liabilities divided by the shareholder's equity. Generally, the lower the ratio, the stronger the company.
- **Return on equity**- A company's shareholder's equity divided by the company's net income after taxes. This is useful when compared over the years to spot trends in investments.

Mutual Funds
Mutual funds are another type of investment. There are thousands of different mutual funds with dozens of different goals and purposes. A mutual fund is a pool of money from individual investors, companies, and other organizations. A professional manager will in turn invest the money in some combination of stocks, bonds, and/or other securities. Mutual funds allow investors to diversify their investments in a more convenient manner. With the wide variety of mutual fund options investors can choose the appropriate risk level to meet their financial goals.

More Information
Playing the stock market can be a difficult and confusing venture. Remember to keep in mind the risk of your investments. To get more help talk to your financial advisor or find one in your area. Many traditional brokerage firms offer a free consultation to discuss your investment goals. You might also find some of the following on-line resources helpful:
- **Investing for Beginners-** http://beginersinvest.about.com/od/investinglessons/
- **Ameritrade-** www.ameritrade.com/education/html/encyclopedia/tutorial1/index.html
- **JoinFinance-** www.joinfinance.com/Learn/stockintro.asp
- **NASD-** www.nasd.com